

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type: <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name: <u>South Haven Community Hospital Authority</u>	County Van Buren
Audit Date June 30, 2005	Opinion Date August 11, 2005	Date Accountant Report Submitted To State: September 26, 2005	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:


1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations.

You must check the applicable box for each item below:

- | | |
|---|---|
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91] or P.A. 55 of 1982, as amended [MCL 38.1132]) |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit. |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241). |
| <input type="checkbox"/> yes <input checked="" type="checkbox"/> no | 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95). |

We have enclosed the following:	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reports on individual federal assistance programs (program audits).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Single Audit Reports (ASLGU).	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>

Certified Public Accountant (Firm Name): Plante & Moran, PLLC			
Street Address 750 Trade Centre Way, Suite 300	City Portage	State MI	ZIP 49002
Accountant Signature 			



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August 11, 2005

To the Finance Committee
South Haven Community Hospital Authority
South Haven, Michigan

Dear Finance Committee Members:

In planning and performing our audit of the financial statements of South Haven Community Hospital Authority for the year ended June 30, 2005, we considered the Hospital's internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Hospital's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

This report contains items considered to be reportable conditions, as defined above, as well as other items we feel warrant your consideration.

Outstanding Checks

Outstanding checks and refund checks from 1993-2003 were still listed on the bank reconciliations as of June 30, 2005. These items totaled more than \$55,000. Checks that are not cashed within five years of issuance should be escheated to the State.

Payroll Documentation

During our review of the payroll process, we noted one employee had 403(b) deductions taken from his pay. Documentation of the employee's approval for these deductions was not located in the applicable personnel file.

Accounts Receivable/Revenue Reports

During our review of the revenue cycle, we noted that subsidiary ledger reports related to accounts receivable and revenue for the Hospital and Clinics were inconsistent. We obtained accounts receivable aging reports by financial class as well as by financial class, split between inpatient and outpatient. In total these reports agreed, however the details between the financial classes differed. It is very important for the Hospital to create accurate reports, so information from one period to the next is comparable and report details are consistent.



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Accounts Receivable

During our review of the accounts receivable balances stated at year end, it was noted gross accounts receivable is up nearly \$4 million dollars or 38 percent as compared to the prior year, while overall gross revenues grew 9 percent. The Hospital maintains this is due to a system conversion that took place at the end of fiscal year 2004 and is corroborated by a significant increase in balances greater than 90 days. Regardless of the reason for the increase in accounts receivable, close monitoring of the aging balances, particularly the oldest ones, is critical for cash flow, and bad debt allowance and expense calculations.

Investment Policy

GASB 40 was implemented for the fiscal year ended June 30, 2005. This pronouncement relates to disclosures in your financial statements for deposits and investments of the Authority. Public Act 20 of 1943, as amended, authorizes the Authority to make deposits and investments in certain types of investment vehicles. We reviewed the Hospital's investment policy and noted that the investment policy does not speak to several items that are required to be disclosed in the footnotes of the financial statements, such as custodial credit risk of bank deposits, custodial credit risk of investments and interest rate risk. We recommend updating your internal policy and informing your investment managers of your policy enhancements.

Wire Transfers

No written policy related to wire transfers is in place at this time. It was noted, however, that proper segregation of duties is in place regarding wire transfers. We recommend the Hospital adopt a written policy that states the procedures they are already following.

Manual Journal Entries

During our review of manual journal entries, it was noted there was a significant amount of journal entries, particularly following the conversion of computer systems, with a description of "cash posting corrections". Further testing showed these journal entries were made due to the fact the billing department was not properly relieving receivables in the new system nor properly posting cash when cash or remittances were received. In conjunction with testing of cash and bank reconciliations, there did not appear to be any significant reconciling items related to these cash posting corrections on a monthly basis, and cash appears properly stated at June 30, 2005.

Also during our journal entry testing, it was noted numerous entries made to adjust for a "zero account". The account was used after the system conversion when the account needed to be used was not linked to the billing code system. After further testing, it was noted that this account has not been used in several months, and it appears the client has resolved any issues they have in linking of accounts to the billing code system.

To the Finance Committee
South Haven Community Hospital Authority

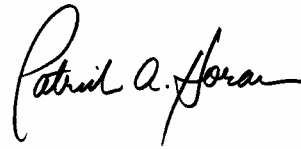
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August 11, 2005

This report is intended solely for the information and use of the audit committee, board of directors, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Plante & Moran, PLLC

A handwritten signature in black ink, reading "Patrick A. Horan". The signature is written in a cursive style with a large initial "P" and a long, sweeping underline.

Patrick A. Horan, CPA
Partner

South Haven Community Hospital Authority

Financial Report
June 30, 2005

South Haven Community Hospital Authority

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Independent Auditor's Report

To the Board of Trustees
South Haven Community Hospital Authority

We have audited the accompanying balance sheet of South Haven Community Hospital Authority (the "Hospital") as of June 30, 2005 and 2004 and the related statements of revenue, expenses, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of South Haven Community Hospital at June 30, 2005 and 2004 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, the Hospital adopted the provision of Governmental Accounting Standards Board Statement No. 40 *Deposits and Investment Risk Disclosures* as of July 1, 2004.

The accompanying financial statements do not present the management's discussion and analysis, which would be an analysis of the financial performance for the year. The Governmental Accounting Standards Board has determined that this analysis is necessary to supplement, although not required to be part of, the basic financial statements.

Plante & Moran, PLLC

August 11, 2005

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South Haven Community Hospital Authority

Balance Sheet

	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Assets		
Current Assets		
Cash and cash equivalents (Note 2)	\$ 1,408,495	\$ 2,628,450
Accounts receivable (Note 4)	3,701,261	2,405,784
Assets limited as to use (Note 3)	-	967,191
Other current assets	642,923	503,644
Total current assets	5,752,679	6,505,069
Assets Limited as to Use (Note 3)	10,080,230	11,177,421
Property and Equipment - Net (Note 5)	15,918,280	14,899,379
Total assets	<u>\$ 31,751,189</u>	<u>\$ 32,581,869</u>
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 8)	\$ 473,333	\$ 473,333
Accounts payable	1,262,106	928,399
Cost report settlements payable (Note 7)	1,841,353	1,945,683
Retainage payable	113,055	466,896
Accrued liabilities and other (Note 6)	1,305,228	1,589,560
Total current liabilities	4,995,075	5,403,871
Long-term Debt (Note 8)	6,153,334	6,626,667
Total liabilities	11,148,409	12,030,538
Net Assets		
Invested in capital assets - Net of related debt	9,291,613	7,799,379
Net assets - Donor restricted for specific operating activities	22,109	200
Unrestricted	11,289,058	12,751,752
Total net assets	20,602,780	20,551,331
Total liabilities and net assets	<u>\$ 31,751,189</u>	<u>\$ 32,581,869</u>

South Haven Community Hospital Authority

Statement of Revenue, Expenses, and Changes in Net Assets

	Year Ended	
	June 30, 2005	June 30, 2004
Operating Revenue		
Net patient service revenue	\$ 24,660,687	\$ 22,107,264
Other	101,813	104,656
Total operating revenue	24,762,500	22,211,920
Operating Expenses		
Salaries and wages	10,939,347	10,050,551
Employee benefits and payroll taxes	2,517,294	2,195,548
Operating supplies and expenses	3,347,553	3,370,897
Professional services and consultant fees	1,915,322	1,471,577
Purchased services	2,414,406	2,089,124
Insurance	527,706	440,025
Utilities and maintenance	1,084,142	832,608
Other	417,753	319,044
Depreciation and amortization	1,989,259	1,636,723
Total operating expenses	25,152,782	22,406,097
Operating Loss	(390,282)	(194,177)
Nonoperating Income - Net (Note 11)	441,730	241,879
Increase in Net Assets	51,449	47,702
Net Assets - Beginning of year	20,551,331	20,503,629
Net Assets - End of year	<u>\$ 20,602,780</u>	<u>\$ 20,551,331</u>

South Haven Community Hospital Authority

Statement of Cash Flows

	Year Ended	
	June 30, 2005	June 30, 2004
Cash Flows from Operating and Nonoperating Activities		
Cash received from patients and third-party payors	\$ 23,260,880	\$ 21,845,644
Cash payments to suppliers for services and goods	(23,243,426)	(20,393,516)
Other receipts from operations	101,813	104,656
Net cash provided by operating activities	119,267	1,556,784
Cash Flows from Noncapital Financing Activities		
Property taxes	365,107	316,145
Donations and other receipts	43,268	45,112
Net cash provided by noncapital financing activities	408,375	361,257
Cash Flows from Investing Activities		
Increase in assets limited as to use	1,015,193	(674,931)
Income received from investments	471,354	495,194
Purchase of investments	-	2,906,337
Rental receipts - Net of expenses paid	8,239	14,869
Net cash provided by investing activities	1,494,786	2,741,469
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(3,485,237)	(6,648,379)
Proceeds from sale of capital assets	35,398	-
Issuance of long-term debt	-	7,100,000
Interest paid on long-term debt	(286,402)	(205,421)
Principal payments on notes payable	(473,333)	(2,393,801)
Net cash used in capital and related financing activities	(4,209,574)	(2,147,601)
Net (Decrease) Increase in Cash and Cash Equivalents	(2,187,146)	2,511,909
Cash and Cash Equivalents - Beginning of year	3,595,641	1,083,732
Cash and Cash Equivalents - End of year	\$ 1,408,495	\$ 3,595,641
Supplemental Cash Flow Information		
Current assets	\$ 1,408,495	\$ 2,628,450
Assets limited as to use	-	967,191
Total	\$ 1,408,495	\$ 3,595,641

South Haven Community Hospital Authority

Statement of Cash Flows (Continued)

A reconciliation of operating income (loss) to net cash from operating activities is as follows:

	Year Ended	
	June 30, 2005	June 30, 2004
Cash Flows from Operating Activities		
Operating loss	\$ (390,282)	\$ (194,177)
Adjustments to reconcile operating loss to net cash from operating activities:		
Depreciation	1,989,259	1,636,723
Provision for bad debts	4,711,831	3,055,122
Increase in assets:		
Patient accounts receivable	(6,007,308)	(3,389,107)
Other current assets	(129,278)	(15,834)
Increase (decrease) in liabilities:		
Accounts payable	333,707	77,265
Other accrued expenses	(284,332)	314,427
Third-party settlement payables	(104,330)	72,365
Net cash provided by operating activities	<u>\$ 119,267</u>	<u>\$ 1,556,784</u>

Significant noncash investing, capital, and financing activities are as follows:

Medical office building rent, net includes an allocation of depreciation expense amount to \$67,240 and \$36,000 in 2005 and 2004, respectively.

The net decrease in fair value of investments for years ended June 30, 2005 and 2004 amounted to \$81,998 and \$284,764, respectively.

A loss on disposal of assets for the years ended June 30, 2005 and 2004 amounted to \$20,598 and \$43,256, respectively.

Included in capital assets at June 30, 2005 and 2004 is \$113,055 and \$466,896, respectively, of construction in progress financed by accounts payable.

During the year ended June 30, 2004, the Hospital wrote off \$60,000 of previously recorded other assets, which is included in other nonoperating expenses.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note I - Nature of Business and Significant Accounting Policies

Reporting Entity - South Haven Community Hospital Authority (the "Hospital") is a short-term, acute-care facility offering inpatient and outpatient health care services primarily to citizens of South Haven, Michigan and several adjacent townships. The Authority is organized pursuant to Public Act 47, of the Public Act 5 of 1945. A significant portion of the Authority's receivables relates to contractual arrangements with Medicare, Medicaid, and Blue Cross programs.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Basis of Presentation - The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital follows the "business-type" activities reporting requirements of GASB Statement No. 34, which provide a comprehensive look at the Hospital's financial activities. No component units are required to be reported in the Hospital's financial statements.

Proprietary Fund Accounting - The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents - Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less, excluding those amounts included in assets limited as to use.

Assets Limited as to Use - Assets limited as to use include assets set aside by the board of trustees for future capital improvements and current projects in progress, over which the board retains control and may, at its discretion, subsequently use for other purposes.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Investments - Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheet. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in nonoperating income.

Property and Equipment - Property and equipment are recorded at cost. Donations of property and equipment are recorded at fair market value at the date of donation. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets. Costs of maintenance and repairs are charged to expense when incurred.

Compensated Absences - Compensated absences are charged to operations when they are earned. Unused benefits are recorded in accrued liabilities on the financial statements.

Classification of Net Assets - Net assets of the Hospital are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets are noncapital net assets that must be used for a particular purpose, as specified by those creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures. Unrestricted net assets are remaining net assets that do not meet the definition of the other two categories of net assets. Included in the unrestricted net assets reported at June 30, 2005 and 2004 is \$10,080,230 and \$11,177,421, respectively, which has been designated by the Hospital's board of trustees for future capital acquisitions. Designated funds remain under the control of the board of trustees, which may, at its discretion, later use the funds for other purposes.

Net Patient Service Revenue - Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined (see Note 7). In addition to contractual provisions, net patient service revenue is presented net of provision for bad debts of \$4,711,831 and \$3,055,122 in 2005 and 2004, respectively.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care was less than 1 percent of total services provided for the years ended June 30, 2005 and 2004.

Operating Revenues and Expenses - The Hospital's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Hospital's principal activity. Operating expenses are all expenses incurred to provide health care services, other than financing costs. Nonoperating activities, including investment income and contributions received for purposes other than capital asset acquisition, and interest expense, are reported as nonoperating revenue and expense.

Tax Levy - Property taxes are both measurable and available for use to finance operations are recorded as nonoperating revenue when earned. Property taxes are levied on December 1 and are intended to finance the Hospital's activities of the same fiscal year. Amounts levied are based on assessed property values as of the preceding July 1.

Reclassification - Certain prior year amounts have been reclassified to conform to the current year presentation.

Note 2 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended), authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 2 - Deposits and Investments (Continued)

The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investments in United States government and agency obligations, commercial paper backed by a bank letter of credit, certificates of deposit (CD) and corporate obligations, but not the remainder of State statutory authority as listed above. The Authority's deposits and investment policies are in accordance with statutory authority.

The Authority's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The government does not have a deposit policy for custodial credit risk. At June 30, 2005, the Authority had \$2,248,540 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The Authority believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Authority evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution. Only those institutions with an acceptable estimated risk level are used as depositories.

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority does not have a policy for custodial credit risk. All the Authority's investment securities were insured and registered, with securities held by the counterparty in the Authority's name. The Authority does have investments held by an investment manager that is not considered a financial institution. They are disclosed below:

Type of Investment	Carrying Value	How Held
Edward Jones	\$ 101,071	Counterparty

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 2 - Deposits and Investments (Continued)

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Authority's investment policy does not restrict investment maturities. At June 30, 2005, the maturities of investments are as follows:

Investment	Fair Value	Maturity Date
Corporate bonds	\$ 1,023,241	2.3 years
Investment pool	200,591	4.4 years
Investment pool	198,498	5.9 years
Investment pool	102,424	4.2 years
Investment pool	881,195	8.5 years

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Authority's policy states all investment grade securities shall be limited to bonds rated AAA, AA, or A by Standard & Poors or Moody's rating systems. As of June 30, 2005, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Corporate bonds	\$ 505,625	A+	Standard & Poors
Corporate bonds	313,869	A	Standard & Poors
Corporate bonds	203,747	AA-	Standard & Poors

Concentration of Credit Risk - The Hospital's policy has placed a limit on the amount of investments that can be held at any one financial institution. The limit per local institution is 50 percent. The Authority's policy also states that at least 50 percent of the invested funds must be maintained in fixed income investments.

Note 3 - Assets Limited as to Use

The detail of assets limited as to use is summarized in the following schedule:

	2005	2004
Trustee-held funds - Project funds	\$ -	\$ 967,191
Board-designated funds - Funded depreciation	\$ 10,080,230	\$ 11,177,421

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 4 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	<u>2005</u>	<u>2004</u>
Patient accounts receivable	\$ 14,501,261	\$ 10,505,784
Less:		
Allowance for uncollectible accounts	4,500,000	2,500,000
Allowance for contractual adjustments and interim payment advances	<u>6,300,000</u>	<u>5,600,000</u>
Total accounts receivable	<u>\$ 3,701,261</u>	<u>\$ 2,405,784</u>

The Hospital is located in South Haven, Michigan. The Hospital provides services without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors is as follows:

	<u>Percentage</u>	
	<u>2005</u>	<u>2004</u>
Medicare	23	18
Blue Cross/Blue Shield of Michigan	12	10
Medicaid	24	24
Commercial insurance and HMOs	8	19
Self-pay	<u>33</u>	<u>29</u>
Total	<u>100</u>	<u>100</u>

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 5 - Capital Assets

Cost of capital assets and related depreciable lives for June 30, 2005 are summarized below:

	2004	Additions	Transfers	Retirements	2005	Depreciable Life - Years
Land and land improvements	\$ 882,447	\$ -	\$ -	\$ -	\$ 882,447	3-25
Building and improvements	15,395,228	348,523	3,535,012	(4,443)	19,274,320	10-40
Furniture, fixtures, and equipment	9,902,692	1,350,435	1,178,166	(1,282,763)	11,148,530	6-20
Construction in progress	4,121,276	1,436,938	(4,713,178)	-	845,036	
Total	30,301,643	3,135,896	-	(1,287,206)	32,150,333	
Less accumulated depreciation:						
Land and land improvements	275,516	18,043	-	-	293,559	
Building and improvements	8,747,497	698,013	-	(4,443)	9,441,067	
Furniture, fixtures, and equipment	6,379,251	1,340,443	-	(1,222,267)	6,497,427	
Total	15,402,264	2,056,499	-	(1,226,710)	16,232,053	
Net carrying amount	<u>\$ 14,899,379</u>	<u>\$ 1,079,397</u>	<u>\$ -</u>	<u>\$ (60,496)</u>	<u>\$ 15,918,280</u>	

Cost of capital assets and related depreciable lives for June 30, 2004 are summarized below:

	2003	Additions	Transfers	Retirements	2004	Depreciable Life - Years
Land and land improvements	\$ 632,181	\$ 250,266	\$ -	\$ -	\$ 882,447	3-25
Building and improvements	12,853,374	2,541,854	-	-	15,395,228	10-40
Furniture, fixtures, and equipment	8,855,529	1,360,460	-	(313,297)	9,902,692	6-20
Construction in progress	1,158,961	2,962,315	-	-	4,121,276	
Total	23,500,045	7,114,895	-	(313,297)	30,301,643	
Less accumulated depreciation:						
Land and land improvements	253,372	22,144	-	-	275,516	
Building and improvements	8,148,973	598,524	-	-	8,747,497	
Furniture, fixtures, and equipment	5,597,617	1,052,055	-	(270,421)	6,379,251	
Total	13,999,962	1,672,723	-	(270,421)	15,402,264	
Net carrying amount	<u>\$ 9,500,083</u>	<u>\$ 5,442,172</u>	<u>\$ -</u>	<u>\$ (42,876)</u>	<u>\$ 14,899,379</u>	

Total depreciation expense, including amortization of capital leases, for the years ended June 30, 2005 and 2004 was \$2,056,499 and \$1,672,723, respectively. Of those amounts, \$1,989,259 and \$1,636,723 was included in operations and \$67,240 and \$36,000, respectively, in nonoperating expenses related to the Medical office building.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 6 - Accrued Liabilities

The details of accrued liabilities at June 30, 2005 and 2004 are as follows:

	2005	2004
Payroll and related items	\$ 407,734	\$ 695,811
Compensated absences	457,986	398,286
Interest	46,791	115,020
Professional liability claims (Note 9)	150,000	100,000
Self insurance liability (Note 9)	89,000	225,000
Other	153,717	55,443
Total accrued liabilities	<u>\$ 1,305,228</u>	<u>\$ 1,589,560</u>

Note 7 - Cost Report Settlements

The Hospital has agreements with third-party payors that provide for payments to the Authority at amounts different from its established rates. Approximately 64 percent of the Hospital's net patient service revenue is received from the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs. Subsidiaries of the Hospital have agreements with third-party payors that provide for reimbursement at amounts different from established rates. A summary of the basis of reimbursement with these third-party payors are as follows:

- **Medicare** - Inpatient, acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient and home care services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.
- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. Rural health clinic services are paid based upon a limited-cost reimbursement methodology. All other outpatient and physician services are reimbursed on an established fee-for-service methodology.
- **Blue Cross/Blue Shield of Michigan** - Under an agreement with Blue Cross, the Hospital is paid based on a cost-plus-reimbursement methodology.

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs, which are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying financial statements.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 8 - Long-term Debt

Long-term liability activity for the year ended June 30, 2005 was as follows:

	<u>2004</u>	<u>Current Year Additions</u>	<u>Current Year Reductions</u>	<u>2005</u>	<u>Amounts Due Within One Year</u>
Series 2004	\$ 7,100,000	\$ -	\$ (473,333)	\$ 6,626,667	\$ 473,333

Long-term liability activity for the year ended June 30, 2004 was as follows:

	<u>2003</u>	<u>Current Year Additions</u>	<u>Current Year Reductions</u>	<u>2004</u>	<u>Amounts Due Within One Year</u>
Farmers Home Administration Loan	\$ 525,000	\$ -	\$ (525,000)	\$ -	\$ -
Series 1986	318,801	-	(318,801)	-	-
Series 1998	1,550,000	-	(1,550,000)	-	-
Series 2004	-	7,100,000	-	7,100,000	473,333
Total long- term debt	<u>\$2,393,801</u>	<u>\$7,100,000</u>	<u>\$(2,393,801)</u>	<u>\$7,100,000</u>	<u>\$ 473,333</u>

The bonds payable are summarized as follows:

- **Bonds Payable** - Series 2004 consisted of South Haven Community Hospital Authority revenue and revenue refunding bonds issued to pay off previous long-term debt and to finance a renovation project. The bonds bear interest ranging from 1.65 percent to 5.4 percent. Principal payments of \$473,333 are due each November 1, beginning in 2004 through 2018. Interest payments are due semi-annually on November 1 and May 1 of the same period. The bonds are collateralized by net revenue of the Authority.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 8 - Long-term Debt (Continued)

The following is a schedule by years of bond principal and interest as of June 30, 2005:

Years Ending June 30	Long-term Debt	
	Principal	Interest
2006	\$ 473,333	\$ 274,888
2007	473,333	263,410
2008	473,333	249,565
2009	473,333	233,827
2010	473,333	197,972
2011-2015	2,366,665	580,781
2016-2019	1,893,337	201,167
Total	\$ 6,626,667	\$ 2,001,610

Total interest expense for the years ended June 30, 2005 and 2004 consisted of amounts included in nonoperating expense of \$286,402 and \$205,421, and related to net medical office expenses of \$0 and \$2,903, respectively.

Note 9 - Risk Management

The Hospital is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The Hospital has purchased commercial insurance for malpractice and general liability claims, and participates in the Michigan Hospital Association risk pool for claims relating to workers' compensation; the Authority is self-insured for employee medical claims. Changes in the estimated liability (included in accrued liabilities) for the past two fiscal years were as follows:

	2005	2004
Estimated liability - Beginning of year	\$ 225,000	\$ 225,000
Estimated claims incurred, including changes in estimates	1,020,367	1,032,754
Claim payments	(1,156,367)	(1,032,754)
Estimated liability - End of year	\$ 89,000	\$ 225,000

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 9 - Risk Management (Continued)

Malpractice - The Hospital is insured against potential professional liability claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital must pay a deductible toward the cost of litigating or settling any asserted claims. In addition, the Hospital bears the risk of the ultimate costs of any individual claim exceeding the policy limits for claims asserted in the policy year.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

The Hospital has been named a defendant in several malpractice suits. All cases involving the authority are in the very early stages and it would be premature to evaluate the likely outcome or, amount of settlement, if any, or whether settlements could exceed the insurance coverage. Management intends to vigorously defend these suits and does not expect any unfavorable impact.

The accrual for estimated malpractice claims was \$150,000 and \$100,000 at June 30, 2005 and 2004, respectively. Management believes, after considering legal counsel's evaluations of all actions and claims, that insurance coverage and accruals for estimated losses are adequate to cover expected settlements.

Note 10 - Tax-deferred Annuity Retirement Plan

The Hospital provides pension benefits to all of its full-time employees through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan, plus investment earnings. Under the plan, the Hospital contributes amounts matching employees' contributions up to 5 percent of base pay for participating employees. In accordance with these requirements, the Hospital contributed \$286,283 during the current year, and employees contributed \$522,001. For the year ended June 30, 2004, the Hospital contributed \$236,338 and employees contributed \$480,230.

South Haven Community Hospital Authority

Notes to Financial Statements June 30, 2005 and 2004

Note 11 - Nonoperating Income - Net

The details of nonoperating income are shown below:

	2005	2004
Income on investments limited as to use for funded depreciation	\$ 451,264	\$ 484,467
Income on investments limited as to use by bond indenture	-	833
Net decrease in fair value of investments	(81,998)	(284,764)
Unrestricted investment income	20,090	9,894
Medical office building - Net loss	(59,001)	(21,131)
Disposal of equipment - Net loss	(20,598)	(43,256)
Donations	21,711	31,850
Tax levy	365,107	316,145
Interest expense	(286,402)	(205,421)
Other	31,557	(46,738)
Total nonoperating income - Net	<u>\$ 441,730</u>	<u>\$ 241,879</u>